

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)
)
Price Cap Performance Review)
for Local Exchange Carriers;)
Treatment of Video Dialtone)
Services Under Price Cap)
Regulation)

CC Docket No. 94-1

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AT&T COMMENTS

Pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, AT&T Corp. ("AT&T") submits these comments on the Commission's Third Further Notice of Proposed Rulemaking ("TFNPRM").¹ The TFNPRM seeks comment (paras. 39-41) on: (1) the proper level of the de minimis threshold above which local exchange carriers ("LECs") are required to segregate video dialtone ("VDT") costs and revenues from those for telephony services for purposes of sharing and the low-end adjustment; and (2) procedures for allocating VDT costs to the VDT basket once the threshold is exceeded. These comments address the two points.

¹ Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Second Report and Order and Third Further Notice of Proposed Rulemaking, FCC 95-394, released September 21, 1995 ("Price Cap Performance Review Order" or "TFNPRM").

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BACKGROUND

In its Price Cap Performance Review Order, the Commission adopted rules regarding the price cap treatment of common carrier VDT services provided by LECs. These rules are designed to prevent the LECs from cross-subsidizing their video dialtone offers through increases in rates in the LEC's other regulated interstate service offerings. The Commission, however, did permit a minor level of cross-subsidization by allowing LECs to include video dialtone costs and revenues in the calculation of the LEC's interstate earnings until a de minimis threshold is exceeded.² The Commission in the TFNPRM requested comments on the specific level for the de minimis threshold and the procedures for allocating costs to the VDT basket for purposes of sharing and the low-end adjustment once a LEC exceeds the threshold.

² Price Cap Performance Review Order at paras. 35-36. The Commission also: (1) established a separate price cap basket for video dialtone service; (2) assigned a zero "productivity" or X-Factor to video dialtone services in the basket; (3) set the initial price cap indices for the video dialtone basket to reflect the VDT rates in effect when the service is brought under price cap regulation; (4) declined to establish service subcategories for the price cap basket; and (5) required LECs to segregate video dialtone costs and revenues from those for telephony service for purposes of sharing and the low-end adjustment once LEC provision of video dialtone exceeds a de minimis threshold. Price Cap Performance Review Order at para. 1.

I. THE DE MINIMIS THRESHOLD SHOULD BE SET AT AN AMOUNT OF VIDEO DIALTONE INVESTMENT THAT WOULD REDUCE THE LEC OVERALL RATE OF RETURN BY FIVE BASIS POINTS OR \$100,000, WHICHEVER IS GREATER.

The Commission seeks comments (TFNPRM, para. 39) on what level to set the de minimis threshold. The Commission proposes basing the threshold on data submitted by carriers under Responsible Accounting Officer ("RAO") Letter 25.³ Specifically, the Commission suggests (para. 40) setting the threshold at the amount of dedicated video dialtone investment that would reduce the LEC overall rate of return by a specified amount, such as 10 or 25 basis points.

While AT&T strongly agrees with the Commission's suggested approach, the reduction amount suggested by the Commission is too high. Using 10 or 25 basis points will permit LECs to reduce their sharing obligations in an amount that is more than de minimis. Rather, the Commission should use an amount that more equitably balances the competing goals of avoiding the imposition of an unnecessary administrative burden on LECs for excluding VDT costs and revenues from the LECs' interstate rate of return calculation for sharing, and ensuring that the customers of the LECs' telephony services are not unreasonably subsidizing the LECs' entrance into the VDT

³ Responsible Accounting Officer Letter 25, DA 95-703, released Apr. 3, 1995, applications for review pending.

marketplace.⁴ As explained in more detail below, AT&T proposes using five basis points to set the threshold.

In addition to lowering the basis point level, the de minimis threshold should be set at an amount that includes both dedicated and shared video dialtone investment. Inclusion of such shared investment would produce a more accurate picture of the actual costs being incurred by LECs in developing their VDT offerings. Moreover, without the inclusion of VDT shared costs in determining the threshold, it is not possible to accurately measure the impact of VDT on the LECs' rate of return. Finally, including the shared VDT investment does not impose an unnecessary administrative burden on the LECs, because the LECs are currently required to capture such VDT costs in FCC Report 43-09B.⁵

AT&T performed an analysis of the impact of different de minimis threshold levels in order to determine the impact on the LECs' rate of return, and thus

⁴ Price Cap Performance Review Order at para. 35.

⁵ The LECs have been recently required to file annual reports that, among other things, contain wholly dedicated and shared VDT costs captured in subsidiary accounting records. Reporting Requirements on Video Dialtone Costs and Jurisdictional Separations for Local Exchange Carriers Offering Video Dialtone Services, Memorandum Opinion and Order, DA 95-2026, AAD No. 95-59, released September 29, 1995 (para. 1). The shared costs are captured in FCC Report 43-09B, ARMIS VDT Fourth Quarter Report.

the monetary effect on the LECs' sharing obligations.⁶ Specifically, AT&T examined the impact of various de minimis thresholds on all LECs as though they selected the 4.0 and 4.7 X-factors in order to estimate the potential impact on sharing.⁷ For example, using 1994 revenue and cost data submitted by the LECs to the Commission and an X-factor of 4.0, the total sharing obligation would be approximately \$824 million. Using the same cost information at a five-basis-point threshold, the sharing obligation would be \$802 million, a \$22 million reduction.⁸ If, on the other hand, 10 and 25 basis points are used, as suggested by the Commission, the total

⁶ See Attachments 1 and 2 for analysis of the impact of various basis points and X-factors on the reduction in the LEC's sharing obligation. The calculation of the sharing obligation includes federal and state taxes and one year's interest at 11.25%.

⁷ The analysis performed by AT&T makes certain assumptions in order to illustrate the potential impact of using various basis point levels and various X-factors. Under the price caps system as implemented by the Commission, unless a carrier has selected the highest X-factor of 5.3 percent, the carrier must share with ratepayers a portion of its profits above a certain benchmark and share all profits above another benchmark. While the majority of price cap LECs have selected a 5.3 X-factor, and are therefore not required to share, these LECs retain the option and ability to change to a different X-factor, one that requires sharing. The LECs may elect a different X-factor each year. 47 C.F.R. §61.45(b)(1) ("... the X-value applicable to the baskets ... shall be 4.0%, or 4.7%, or 5.3%, as the carrier elects.").

⁸ This example is illustrative of the sharing obligation reductions if a five basis point threshold is used with a 4.0 X-factor. If a 4.7 X-factor were used, the sharing obligation reduction would be \$13 million. See Attachment 2.

reduction to the sharing obligation would more than double to \$80 million and \$105 million, respectively. This reduction would result in a significant amount of cross-subsidization of the LECs' VDT offerings by telephony service users.

Turning to the illustrative impact on sharing for an individual LEC, U S WEST's sharing reduction, using the five-basis-point threshold, would be \$1.6 million.⁹ The reduction for U S WEST at 10 and 25 basis points would be \$3 million and \$7 million, respectively. Even a reduction of \$3 million in sharing, as would occur if 10 basis points are used, far exceeds the expected costs associated with excluding VDT costs and revenues from the LEC's interstate earnings.

AT&T acknowledges that this approach may not be appropriate in all circumstances. Some smaller price cap LECs may be subjected to unnecessary administrative burden even when using five basis points as the de minimis threshold. For example, under the above described analysis, the reduction on Lincoln Telephone's sharing obligation would be \$45,000 when using five basis points and a 4.0 X-factor.¹⁰ Because Lincoln and other LECs may incur costs greater than their reduction in sharing

⁹ See Attachments 1 and 2. U S WEST was chosen for illustrative purposes because it currently has chosen an X-factor of 4.0 and is, therefore, subject to sharing.

¹⁰ Id.

(\$45,000 in the case of Lincoln) when excluding the VDT costs and revenues, AT&T proposes that in those cases where a LEC's sharing obligation is reduced by less than \$100,000, that a flat \$100,000 de minimis threshold be applied.

In sum, the appropriate threshold should be set at the amount of dedicated and shared VDT investment that would reduce the LEC overall rate of return by no more than five basis points, or \$100,000, whichever is greater. Not only does this approach have the benefit of using shared VDT costs, it also assures that VDT costs and revenues are excluded from the calculation of the LEC's interstate earnings when separating out those costs no longer imposes an unnecessary administrative burden on the LEC.

II. AFTER THE THRESHOLD IS PASSED, VDT COSTS SHOULD BE ALLOCATED ONLY AFTER PART 36 AND PART 69 COST STUDIES HAVE BEEN PERFORMED.

The Commission also seeks comment (TFNPRM at para. 41) on a method or factor to be used in Part 69 (47 C.F.R. §69) for allocating video dialtone costs to the VDT basket for sharing and the low-end adjustment once the threshold has been passed in the case of LECs that select an X-factor with sharing and a low-end adjustment for telephony. The Commission suggests two potential methods: (1) a fixed cost allocation factor; or (2) use of the new services test. Neither of these approaches, however, will provide the proper allocation of VDT costs to the VDT

basket. Rather the Commission should require LECs to perform full Part 36 (47 C.F.R. §36, Jurisdictional Separations) and Part 69 (Interstate Access) cost studies for video dialtone costs after the de minimis threshold is exceeded. In addition, because video dialtone is fundamentally different than the basic telephony services, it may warrant a separate Part 36 category.

The use of a fixed cost allocation factor to separate video dialtone costs from the telephony services, while "relatively simple to administer," would lead to potentially skewed results. A single allocation factor applied to all LECs fails to account for the differences in LEC cost structures and the differences in technologies employed by various LECs for their VDT services. Consequently, any cost allocation factor should be developed for each individual LEC, based on the LEC's specific cost and usage studies for the provision of video dialtone service.

Similarly, using the approach in the new services test will result in the application of a non-usage based, fixed allocation factor to separate VDT costs for Part 69. Such an allocation factor would be based solely on the LECs' cost data submitted with initial video dialtone services, which does not take into account cost data related to subsequent VDT service growth or changes in technology. As a result, the use of a fixed allocation factor based on this type of initial cost data will fail to reflect changes in video dialtone service as the demand

for, and the related costs of, the service grows. On the other hand, a usage-based allocation factor that represents annual changes in the LECs' VDT costs best reflects the actual costs incurred by the LECs in their development and provision of VDT services. Therefore, the Commission should not adopt the new services test, as it is currently implemented, as a method to allocate VDT costs to the VDT basket.

In summary, it is premature to apply any methodology to Part 69 for allocating video dialtone costs, unless Part 36 is modified to reflect video dialtone costs and usage. Therefore, video dialtone costs should be allocated to the video dialtone basket, after the de minimis threshold is exceeded, upon the completion of full Part 36 and Part 69 cost studies.

CONCLUSION

For the reasons stated above, the Commission should set the de minimis threshold at the amount of dedicated and shared VDT investment that would reduce the LEC overall rate of return by five basis points, or \$100,000, whichever is the greater reduction in sharing obligation. The Commission should require full Part 36

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and Part 69 cost studies for allocating VDT costs to the VDT basket for purposes of sharing and the low-end adjustment once the threshold has been passed.

Respectfully submitted,

AT&T Corp.

By



Mark C. Rosenblum

Ava D. Kleinman

Seth S. Gross

Its Attorneys

Room 3545F3

295 North Maple Avenue

Basking Ridge, New Jersey 07920

(908) 221-8312

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**CALCULATION of REDUCTION IN PRICE CAP LECs' SHARING at 4.0 X FACTOR,
FOR 5, 10, and 25 BASIS POINTS DECREASE IN RATE of RETURN
BASED ON 1995 FORM 492-A REPORTS**

ATTACHMENT 1

LEC	SHARING at 4.0 X FACTOR	WITH 5 BASIS POINT REDUCTION	WITH 10 BASIS POINT REDUCTION	WITH 25 BASIS POINT REDUCTION	NET SHARING REDUCTION FOR 5 BASIS POINT DECREASE IN ROR	NET SHARING REDUCTION FOR 10 BASIS POINT DECREASE IN ROR	NET SHARING REDUCTION FOR 25 BASIS POINT DECREASE IN ROR
Ameritech	(64,761)	(62,098)	(59,434)	(51,443)	(2,664)	(5,327)	(13,319)
Bell Atlantic	(140,146)	(136,484)	(132,822)	(121,836)	(3,662)	(7,324)	(18,310)
BellSouth	(265,518)	(261,391)	(257,264)	(244,883)	(4,127)	(8,254)	(20,635)
Lincoln Telephone	(2,853)	(2,808)	(2,763)	(2,629)	(45)	(90)	(224)
NYNEX	0	0	0	0	0	0	0
Pacific Tel - CA	(113,847)	(111,603)	(109,359)	(102,626)	(2,244)	(4,488)	(11,221)
Pacific Tel - NV	(6,218)	(6,161)	(6,104)	(5,933)	(57)	(114)	(284)
Rochester Tel	0	0	0	0	0	0	0
SNET	0	0	0	0	0	0	0
Southwestern Bell	(37,277)	(34,516)	(31,755)	(25,542)	(2,761)	(5,523)	(11,735)
US WEST	(7,023)	(5,389)	(3,755)	0	(1,634)	(3,268)	(7,024)
Vista	(4,187)	(4,157)	(4,126)	(4,035)	(30)	(61)	(152)
CENTEL	(25,243)	(24,953)	(24,663)	(23,794)	(290)	(580)	(1,449)
UNITED	(90,504)	(89,549)	(84,091)	(85,732)	(954)	(6,412)	(4,772)
CONTEL	(66,054)	(65,608)	(33,255)	(63,824)	(446)	(32,799)	(2,230)
GTE	(64)	2,721	5,510	13,895	(2,785)	(5,574)	(13,959)
TOTAL	(823,695)	(801,996)	(743,882)	(718,381)	(21,699)	(79,813)	(105,314)

**CALCULATION of REDUCTION IN PRICE CAP LECs' SHARING at 4.7 X FACTOR,
FOR 5, 10, and 25 BASIS POINTS DECREASE IN RATE of RETURN
BASED ON 1995 FORM 492-A REPORTS**

ATTACHMENT 2

LEC	SHARING at 4.7 X FACTOR	WITH 5 BASIS POINT REDUCTION	WITH 10 BASIS POINT REDUCTION	WITH 25 BASIS POINT REDUCTION	NET SHARING REDUCTION FOR 5 BASIS POINT DECREASE IN ROR	NET SHARING REDUCTION FOR 10 BASIS POINT DECREASE IN ROR	NET SHARING REDUCTION FOR 25 BASIS POINT DECREASE IN ROR
Ameritech	(45,699)	(44,367)	(43,036)	(39,040)	(1,332)	(2,664)	(6,659)
Bell Atlantic	(88,383)	(86,552)	(84,721)	(79,228)	(1,831)	(3,662)	(9,155)
BellSouth	(153,394)	(151,331)	(149,267)	(143,077)	(2,064)	(4,127)	(10,318)
Lincoln Telephone	(1,651)	(1,628)	(1,606)	(1,538)	(22)	(45)	(112)
NYNEX	0	0	0	0	0	0	0
Pacific Tel - CA	(68,145)	(67,023)	(65,900)	(62,534)	(1,122)	(2,244)	(5,611)
Pacific Tel - NV	(4,511)	(4,455)	(4,398)	(4,227)	(57)	(114)	(284)
Rochester Tel	0	0	0	0	0	0	0
SNET	0	0	0	0	0	0	0
Southwestern Bell	(32,445)	(31,064)	(29,684)	(25,542)	(1,381)	(2,761)	(6,903)
US WEST	(7,023)	(5,389)	(3,755)	0	(1,634)	(3,268)	(7,024)
Vista	(3,277)	(3,246)	(3,216)	(3,125)	(30)	(61)	(152)
CENTEL	(17,921)	(17,675)	(17,429)	(16,690)	(246)	(493)	(1,231)
UNITED	(63,397)	(62,572)	(61,746)	(59,270)	(825)	(1,651)	(4,127)
CONTEL	(56,827)	(56,438)	(56,049)	(54,883)	(389)	(778)	(1,944)
GTE	24,542	26,920	29,298	36,449	(2,378)	(4,756)	(11,906)
TOTAL	(518,131)	(504,820)	(491,509)	(452,705)	(13,312)	(26,623)	(65,427)

CERTIFICATE OF SERVICE

I, Ann Marie Abrahamson, do hereby certify that on this 27th day of October, 1995, a copy of the foregoing "AT&T Comments" was mailed by U.S. first class mail, postage prepaid, to the parties listed on the attached Service List.


Ann Marie Abrahamson

SERVICE LIST
(Docket 94-1 - VDT Price Cap Treatment)

James S. Blaszak
Levine, Blaszak, Block & Boothby
1300 Connecticut Ave., NW
Washington, D.C. 20036-1703
Attorneys for Ad Hoc
Telecommunications User Committee

Lee L. Selwyn
Patricia D. Kravtin
Economics and Technology, Inc.
One Washington Mall
Boston, MA 02108-2617
Economic Consultants for Ad Hoc
Telecommunications User Committee

Michael E. Glover
Edward Shakin
Edward D. Young, III
Bell Atlantic
1320 North Court House Rd.
Arlington, VA 22201

M. Robert Sutherland
Richard M. Sbaratta
BellSouth Telecommunications, Inc.
4300 Southern Bell Center
675 W. Peachtree St., N.E.
Atlanta, GA 30375

Alan J. Gardner
Jerry Yanowitz
Jeffrey Sinsheimer
California Cable Television Assn.
4341 Piedmont Ave.
Oakland, CA 94611

Frank W. Lloyd
Donna N. Lampert
James J. Valentino
Mintz, Levin, Cohn, Ferris,
Glovsky and Popeo, P.C.
701 Pennsylvania Ave., NW, Suite 900
Washington, D.C. 20004
Attorneys for California Cable
Television Assn.

Terry L. Murray
Murray and Associates
101 California St., Suite 4225
San Francisco, CA 94111
Economic Consultant for California
Cable Television Assn.

Werner K. Hartenberger
Michael S. Schooler
Laura H. Phillips
Dow, Lohnes & Albertson
1255 23rd St., NW, Suite 500
Washington, D.C. 20037
Counsel for Cox Enterprises, Inc.

Emily C. Hewitt
Vincent L. Crivella
Michael J. Ettner
Tenley A. Carp
General Services Administration
18th & F Sts., NW, Room 402
Washington, D.C. 20405

Snavelly, King & Associates
1220 L St., NW
Washington, D.C. 20005
Economic Consultant for General
Services Administration

Richard McKenna, HQE03J36
GTE Service Corporation
P.O. Box 152092
Irving, TX 75015-2092

Gail L. Polivy
GTE Service Corporation
1850 M St., NW, Suite 1200
Washington, D.C. 20036

Michael Hydock
MCI Telecommunications Corp.
1801 Pennsylvania Ave., NW
Washington, D.C. 20006

Daniel L. Brenner
Neal M. Goldberg
David L. Nicoll
National Cable Television Assn., Inc.
1724 Massachusetts Ave., NW
Washington, D.C. 20036

Philip L. Verveer
Sue D. Blumenfeld
Thomas Jones
Willkie Farr & Gallagher
Three Lafayette Centre
1155 21st St., NW
Washington, D.C. 20036
Counsel for National Cable
Television Assn., Inc.

Barry S. Abrams
Campbell L. Ayling
NYNEX
1111 Westchester Ave.
White Plains, NY 10604

Alan F. Ciamporcerio
Pacific Telesis
Group-Washington
Federal Regulatory Relations
1275 Pennsylvania Ave., NW, Suite 400
Washington, D.C. 20004

James P. Tuthill
Lucille M. Mates
John Bogy
Pacific Bell
140 New Montgomery St., Rm. 1526
San Francisco, CA 94105

James L. Wurtz
Margaret E. Garber
Pacific Bell
1275 Pennsylvania Ave., NW
Washington, D.C. 20004

Michael J. Shortley, III
Rochester Telephone Corp.
180 South Clinton Ave.
Rochester, NY 14646

Robert M. Lynch
Durward D. Dupre
Thomas A. Pajda
Anthony K. Conroy
Southwestern Bell Telephone Company
One Bell Center, Suite 3520
St. Louis, MO 63101

Jay C. Keithley
United and Central Telephone Companies
1850 M St., NW, Suite 1100
Washington, D.C. 20036

Craig T. Smith
United and Central Telephone Companies
P.O. Box 11315
Kansas City, MO 64112

Mary McDermott
Linda Kent
Charles D. Cosson
United States Telephone Assn.
1401 H St., NW, Suite 600
Washington, D.C. 20005

James T. Hannon
Sharon L. Naylor
Laurie J. Bennett
U S WEST Communications, Inc.
1020 19th St., NW, Suite 700
Washington, D.C. 20036